

UNITED STATES OF AMERICA  
POSTAL REGULATORY COMMISSION  
WASHINGTON, DC 20268-0001

Statutory Review of the System  
for Regulating Rates and Classes  
for Market Dominant Products

Docket No. RM2017-3

REPLY COMMENTS OF THE PUBLIC REPRESENTATIVE

March 30, 2018

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## I. INTRODUCTION

The Public Representative hereby files his Reply Comments in response to the initial comments of various participants filed March 1, 2018 pursuant to Commission Order No. 4258.<sup>1</sup> The Public Representative submitted initial comments<sup>2</sup> together with the sworn declarations of Dr. John Kwoka, Dr. Robert W. Wilson,<sup>3</sup> Dr. Timothy J. Brennan,<sup>4</sup> and Lyudmila Bzhilyanskaya.<sup>5</sup>

The Commission established this docket on December 1, 2017, pursuant to § 3622(d)(3) of the Postal Accountability and Enhancement Act (PAEA) initiating its 10-year review to consider changes to the regulatory system governing market dominant products established by the PAEA. The changes proposed by Order No. 4258 are intended to rectify the Commission's finding in Order No. 4257 that the existing "system as a whole has not achieved the objectives of the PAEA."<sup>6</sup>

It is now apparent that fundamental assumptions underlying the PAEA were incorrect. Most significantly, declines in mail volume were not gradual enough to permit

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<sup>1</sup> Order No. 4258, Notice of Proposed Rulemaking for the System for Regulating Rates and Classes for Market Dominant Products, December 1, 2017 (Order No. 4258 or NOPR). In its notice, the Commission designated the undersigned to serve as Public Representative. Order No. 4258 at 131.

<sup>2</sup> Initial Comments of the Public Representative, March 1, 2018 (PR Initial Comments). On March 7, 2018, a Notice of Errata was filed together with a corrected copy of the Initial Comments of the Public Representative dated March 7, 2018.

<sup>3</sup> Declaration of John Kwoka and Robert Wilson, March 1, 2018 (Kwoka/Wilson Decl.). Dr. Kwoka is currently the Neal F. Finnegan Distinguished Professor of Economics at Northeastern University. Dr. Wilson is a consulting economist and formerly a principal at The Brattle Group.

<sup>4</sup> Supplemental Declaration of Timothy J. Brennan for the Public Representative, March 1, 2018 (Brennan Supp. Decl.). Dr. Brennan is currently Professor of Public Policy and Economics in the School of Public Policy at the University of Maryland, Baltimore County.

<sup>5</sup> Supplemental Declaration of Lyudmila Y. Bzhilyanskaya for the Public Representative, March 1, 2018 (Bzhilyanskaya Supp. Decl.). Dr. Bzhilyanskaya is a Senior Econometrician in the Commission's Office of Accountability and Compliance.

<sup>6</sup> Order on the Findings and Determination of the 39 U.S.C. § 3622 Review, December 1, 2017, at 275 (Order No. 4257).

the Postal Service to adapt its operations in an organized manner. The Great Recession precipitated steep declines in mail volume.<sup>7</sup> Since the end of the Great Recession, the expanding internet has hastened the continuing decline in mail volumes, including declines in the volume of First-Class Mail, the Postal Service's most profitable class of mail. As a result, the Postal Service was unable to generate sufficient revenue to prefund a substantial portion of retiree health benefits. Without breaking even or producing retained earnings, it could not support new investments and meet all remaining financial obligations.<sup>8</sup>

In Order No. 4257, the Commission correctly concluded that the current system is not achieving the statutory objective of financial stability and not generating retained earnings that are fundamental to the achievement of other statutory objectives. The Public Representative and most major mailers filing initial comments support the Commission's conclusion that additional revenue is necessary in the form of increased rates to improve the Postal Service's financial situation. A few prefer the *status quo*.

In the initial comments, the Public Representative made four primary recommendations for modifying the existing price cap system at variance with the Commission's proposal in Order No. 4258:<sup>9</sup>

- Retain price cap and make principled adjustments consistent with price cap theory;
- Adjust the price cap for exogenous factors;
- Adjustment to address non-compensatory rates; and

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<sup>7</sup> See Docket No. R2013-11, Order Granting Exigent Price Increase, December 24, 2013, at 83-94 (Order No. 1926).

<sup>8</sup> S. Rep. No. 108-318, 108<sup>th</sup> Cong., 2d Sess. (Aug. 25, 2004) at 8.

<sup>9</sup> PR Initial Comments at 40-63.

- Shorten the period before the next review.

The recommended changes are based upon price cap principles discussed in the Public Representative's previous comments in this proceeding.<sup>10</sup> In these Reply Comments, the Public Representative continues to advocate that the addition of a "z" factor to the CPI-U price cap equation will ensure recovery of exogenous costs for certain pension and health benefit obligations as well as to factor in the cost of volume declines to maintain net revenue neutrality. This will enable the Postal Service to recover costs that are beyond the control of management. Such costs are responsible for the Postal Service's financial instability and therefore need to be included in the price cap calculation.

The issue of treatment for the non-compensatory class of mail, Periodicals, requires special attention. In these Reply Comments, the Public Representative offers revised suggestions for pricing Periodicals going forward.

## II. EXECUTIVE SUMMARY

These Reply Comments respond to initial comments filed in this proceeding on March 1, 2018. Those comments recommended specific modifications to the Commission's proposed modifications to the current market dominant system that addressed the adverse effects of particular flaws in the system's design. The Public Representative's proposals were based upon the Commission's authority to make changes to the system and upon traditional price cap principles as incorporated by the PAEA.

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<sup>10</sup> Comments of the Public Representative, March 21, 2017 (PR 2017 Comments). The Public Representative's comments were filed in response to a December 20, 2016 Advance Notice of Proposed Rulemaking (ANOPR). Accompanying the Public Representative's comments were the sworn declarations of Dr. John Kwoka, Dr. Timothy J. Brennan, and Dr. Lyudmila Y. Bzhilyanskaya. Declaration of John Kwoka, March 20, 2017 (Kwoka Decl.); Declaration of Timothy J. Brennan for the Public Representative, March 20, 2017 (Brennan 2017 Decl.); and Declaration of Lyudmila Y. Bzhilyanskaya for the Public Representative, March 20, 2017 (Bzhilyanskaya 2017 Decl.).

The changes recommended by the Public Representative would allow the Postal Service to seek recovery of costs due to factors beyond its control—so-called exogenous costs. More specifically, the Public Representative's recommended changes would authorize the possible recovery of certain costs of retiree health and pension benefit plans. Recent legislative proposals seek to address some of the major problems confronting the Postal Service. Those proposals do not, however, eliminate the need for Commission action. Both regulatory and legislative action are needed.

The Public Representative's proposal also included suggested adoption of a mechanism that would permit the Postal Service to recover costs associated with declining demand driven by exogenous factors such as changes in demographics and consumer preferences. Finally, the Public Representative recommended an adjustment to the price cap covering the Periodicals Class to permit full cost recovery. All of these proposed changes were supported by the declarations of qualified experts.

In recognition of the potential impact of these changes on Postal Service customers, the Public Representative has proposed phasing in the changes. He has also acknowledged that because the Postal Service can exercise control over the additional costs of the Periodicals Class that it would be eligible to recover, it would be necessary for the Commission to determine whether any of these costs should be excluded from the amount by which the cap for the Periodicals Class would be increased.

These comments address issues concerning:

In Section III. A., the Public Representative supports the Commission by responding to arguments that the Commission lacks authority to make modifications to the current market dominant system that would give the Postal Service additional rate authority. The Public Representative also suggests that in future orders the Commission provide additional support for its position by interpreting potentially

ambiguous statutory provisions. The Public Representative has previously addressed this issue. PR 2017 Comments at 29-30; and PR Initial Comments at 7-10.

In Section III. B., the Public Representative urges the Commission to find that the current market dominant system is failing to achieve short-term Postal Service financial stability. The Commission's previous finding that short-term financial stability had been achieved is contrary to the record and is arbitrary and capricious. A finding of short-term financial instability is needed to support actions that will provide timely relief to the Postal Service and prevent further deterioration of its medium-term and long-term financial stability. The Public Representative has previously addressed this issue. PR Initial Comments at 10-14, 38-39.

In Section III. C. the Public Representative opposes proposals by the Commission and others that rely upon what can fairly be characterized as partial cost of service proposals. Instead, the Commission should retain the CPI-U-adjusted price cap with adjustments that are based upon established price cap principles that provide the foundation for the current market dominant system. The Public Representative has previously addressed this issue. PR Initial Comments at 15-38.

In Section III. D. the Public Representative opposes proposals to make up Postal Service losses with additional revenue from competitive products. These proposals fail to recognize the contribution that competitive products already make to the Postal Service's institutional costs; advocate a revenue apportionment method rejected by the Commission several times; relies upon a faulty statutory interpretation; and relies inappropriately on projections of increased future competitive product revenue.

In Section III. E., the Public Representative responds to arguments that the Commission, and by implication, the Public Representative have improperly relied upon the current system's failure to achieve financial stability to support modifications to the system. The Public Representative opposes attempts to disregard the Postal Service's inability to meet its financial obligations to make payments into retiree benefit programs



as a means of demonstrating financial stability. The Public Representative also challenges assertions that the Postal Service's financial problems are the fault of the Postal Service and that the current system is not responsible. The Public Representative opposes claims that the importance of Objective 5 has been improperly elevated over the importance of other statutory objectives.

In Section III. E. the Public Representative also discusses his proposed modifications to the current system under each of the statutory objectives applicable to that system and explains why he believes his proposals are consistent with, and give adequate consideration to, each objective in conjunction with the others. The Public Representative has previously addressed these issues. PR 2017 Comments at 35-61; and PR Initial Comments at 40-63.

In Section III. F. the Public Representative acknowledges that the need for action to address the Postal Service's financial situation must be balanced against the possible adverse impacts on mailers from modifications to the system. The Public Representative proposes steps to mitigate such impacts. The Public Representative has previously addressed this issue. PR 2017 Comments at 44-47, 55-56; and PR Initial Comments at 23-26, 50, 51.

In Section III. G. the Public Representative agrees with comments that changes to the market dominant system must be undertaken carefully in light of the possibility that postal legislation will be enacted. The Public Representative explains that his proposals are designed to be integrated with recent legislative proposals that appear to be viable options for enactment. The Public Representative has previously addressed this issue. PR 2017 Comments at 33; and PR Initial Comments at 51-55, 63.

In Section III. H., the Public Representative identifies several options available to the Commission in light of the comments filed in this proceeding. The Public Representative urges prompt Commission action on his proposals addressing exogenous factors in order to avoid further deterioration of the Postal Service's financial

situation. The Public Representative also acknowledges that further investigation of additional steps may be necessary and that a further notice of proposed rulemaking may be required.

### III. PUBLIC REPRESENTATIVE RESPONSE TO INITIAL COMMENTS

#### A. Statutory Authority to Revise the Price Cap System

##### 1. Statutory Authority

Several commenters attack the Commission's statutory authority to modify the current CPI-U-adjusted price cap.<sup>11</sup> They argue that the Commission's proposed modification is beyond its authority, or *ultra vires*, because the price cap is a requirement, under 39 U.S.C. § 3622(d)(1)(A). In their view, the price cap is an immutable component of 39 U.S.C. § 3622 and cannot be affected by the Commission's review of the market dominant ratemaking system, pursuant to 39 U.S.C. § 3622(d)(3).

This argument relies on a specific statutory interpretation of 39 U.S.C. § 3622 centered on the statute's use of the word "system." Its proponents argue that, because the word appears in both §§ 3622(a) and (d)(3), it must be given precisely the same meaning. In other words, because the term refers to the Commission's regulations in § 3622(a), they contend that the Commission's review under § 3622(d)(3) must be restricted to those regulations.

Although these commenters correctly note that there is a presumption that words and phrases within a statute have the same meaning, citing *Atl. Cleaners & Dyers, Inc. v. United States*, 286 U.S. 427, 433 (1932), presumptions are merely the starting point

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<sup>11</sup> See e.g., Alliance of Nonprofit Mailers, American Catalog Mailers Association, Inc., Association of Postal Commerce, Idealliance and MPA - the Association of Magazine Media, March 1, 2018, at 9-27 (ANM Comments); Comments of the National Postal Policy Council, the Major Mailers Association, and the National Association of Presort Mailers, March 1, 2018 at 19-35 (NPPC Comments); Initial Comments of the Greeting Card Association, March 1, 2018, at 17-19 (GCA Comments); and Comments of American Bankers Association, March 1, 2018, at 8-10 (ABA Comments).

for statutory interpretation. ANM Comments at 17. Indeed, “[t]he presumption that identical words in different parts of the same Act are intended to have the same meaning, see e.g. *Atlantic Cleaners & Dyers*, is not rigid and readily yields . . . .” *Gen. Dynamics Land Sys., Inc. v. Cline*, 540 U.S. 581, 582 (2004) (internal citation omitted). Applying the presumption rigidly “ignores the cardinal rule that statutory language must be read in context since a phrase gathers meaning from the words around it.” *Id.* (citing *Jones v. United States*, 527 U.S. 373, 389 (1999)).

Here, the context and use of the term is illustrative. Section 3622(a) provides the Commission’s general authority to establish a modern system of regulations in order to effectuate the statute. Section 3622(d)(3), on the other hand, outlines a review process 10 years after the enactment date, through which the Commission must evaluate the ratemaking system and may “make such modification or adopt such alternative system for regulating rates and classes for market-dominant products as necessary to achieve the objectives.” As the Commission concluded, these two subsections serve different purposes. Order No. 4258 at 17.

To begin, if § 3622(d)(3) merely directed the Commission to review its own regulations then it would be largely redundant with § 3622(a). Section 3622(a) already explicitly grants the Commission the power to revise its regulations. Some commenters attempt to address this issue by arguing that § 3622(a) allows the Commission to review its regulations on its own initiative, whereas § 3622(d)(3) compels a mandatory review of those regulations after 10 years.

However, this argument does not address the different triggering conditions and language in each section. Nor does it explain why § 3622(d)(3) provides the Commission with the power to implement a remedy “as necessary to achieve the objectives” without reference to the statute’s other parts, such as the requirements section. The argument also cannot explain the provision’s legislative history, including the Comments by Senator Collins or the McHugh hearings before the House

Subcommittee on the Postal Service of the House Committee on Government Operation and Oversight.<sup>12</sup>

Furthermore, none of the commenters attacking the Commission's statutory authority adequately address the meaning of the phrase "adopt an alternative system" in § 3622(d)(3). Although ANM accurately states that revise and modify are synonyms, its explanation that "adopting an 'alternative' system is a way to 'revise' or 'modify' the original system" is unsatisfying. ANM Comments at 17. The statute's language presents the Commission with two alternative powers: the power to modify the system or the power to adopt an alternative system. These are distinct remedies, separated by the disjunctive "or" in the statute's text.

For these reasons, the Public Representative rejects the statutory interpretation that the Commission's power to review the system for market dominant ratemaking under § 3622(d)(3) cannot affect the price cap. As the Public Representative stated in his initial comments, "[t]he system that is subject to modification or replacement includes the price cap provided for in section 3622(d)(1) and (2)." PR Initial Comments at 30. The Public Representative maintains that, "[w]hat the Commission cannot change are the statutory objectives in section 3622(b) and the factors in section 3622(c) that inform the objectives." *Id.*

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<sup>12</sup> "After 10 years, the Postal Regulatory Commission will review the rate cap and, if necessary, and following a notice and comment period, the Commission will be authorized to modify or adopt an alternative system." 152 Cong. Rec. S 11,675 (daily ed. Dec. 8, 2006) (statement of Sen. Collins). The House Sub-committee was under the Chairmanship of Congressman John M. McHugh. The hearings are referred to as the McHugh Oversight Hearings. Those hearings began on February 23, 1995, and continued periodically through March of 2000. During the course of the hearings, the Committee considered several postal bills. The first bill considered was H.R. 3717, the Postal Reform Act of 1996 (introduced June 25, 1996). In 2001, the full oversight committee took over conduct of the hearings and proceeded to consider several additional postal bills, including the bill ultimately enacted as the PAEA.

## 2. The Commission's Statutory Interpretation

In its Order, the Commission finds that “the *plain meaning* of the PAEA grants the Commission broad authority to engage in rulemaking in order to modify or replace the current ratemaking system.” Order No. 4258 at 19 (emphasis added). The phrase “plain meaning” is a legal term of art used in statutory interpretation to express that the text at issue “has a plain and unambiguous meaning.” *Robinson v. Shell Oil Co.*, 519 U.S. 337, 340 (1997).<sup>13</sup>

As stated above and in previous comments, the Public Representative “endorses the Commission’s *conclusion* that it has broad authority to modify or replace the ratemaking system for market dominant products.” PR Initial Comments at 8 (emphasis added). However, The Public Representative cannot support the Commission’s finding that the text of 39 U.S.C. § 3622 is unambiguous. The Public Representative maintains his initial position that the language of 39 U.S.C. § 3622 is patently ambiguous. PR Initial Comments at 10-13, 18-22. Put simply, the Public Representative agrees with the Commission’s conclusion but not its reasoning.

On appeal, this distinction may prove to be very significant. As previously explained, courts review an agency’s statutory interpretation of unambiguous text under a different standard than an agency’s interpretation of ambiguous statutory language. See PR Initial Comments at 7-8 (citing *Chevron, U.S.A., Inc. v. Natural Res. Def. Council*, 467 U.S. 837 (1984)). The *Chevron* case established a now venerated two-part test. Under step one, if “Congress has directly spoken to the precise question at

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<sup>13</sup> Although the Commission bases its statutory interpretation on the plain meaning of 39 U.S.C. § 3622, it curiously devotes significant discussion to the legislative history of the PAEA. 10 Year Order at 19-23. However, legislative history is only relevant for purposes of statutory interpretation when the underlying statutory language is ambiguous. See e.g., *Park 'N Fly, Inc. v. Dollar Park & Fly, Inc.*, 469 U.S. 189, 194 (1985) (stating that “[s]tatutory construction must begin with the language employed by Congress and the assumption that the ordinary meaning of that language accurately expresses the legislative purpose.”).

issue...that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress.” *Id.* at 842-843. Under step two, “if the statute is silent or ambiguous with respect to the specific issue, the question for the court is whether the agency's answer is based on a permissible construction of the statute.” *Id.* at 843.

In the step two inquiry, courts “have long recognized that considerable weight should be accorded to an executive department's construction of a statutory scheme it is entrusted to administer, and the principle of deference to administrative interpretations[,]” a principle commonly referred to as *Chevron* deference. *Id.* at 844. Although *Chevron* deference can “vary with the circumstances[,]” it provides a “fair measure of deference to an agency administering its own statute.” *United States v. Mead Corp.*, 533 U.S. 218, 228 (2001). Generally, “[t]he weight of such a judgment in a particular case will depend upon the thoroughness evident in its consideration, the validity of its reasoning, its consistency with earlier and later pronouncements, and all those factors which give it power to persuade, if lacking power to control.” *Skidmore v. Swift & Co.*, 323 U.S. 134, 140 (1944). Put succinctly, the degree of deference depends on “the agency's care, its consistency, formality, and relative expertness, and to the persuasiveness of the agency's position.” (Footnotes omitted.) *U.S. v. Mead Corp.*, 533 U.S. 221, 228 (2001).

However, this potentially substantial deference is not applied under *Chevron* step one. Under step one, courts employ traditional tools of statutory construction to interpret the statute *de novo*, or without deference. *Nat'l Ass'n of Clean Air Agencies v. E.P.A.*, 489 F.3d 1221, 1228 (D.C. Cir. 2007). If the court determines that the plain meaning of the statute is clear, the agency's interpretation receives no deference. *Id.*

In practical terms, an appellate court will examine the Commission's initial finding that the text of 39 U.S.C. § 3622 is unambiguous without deference to the Commission's interpretation. If the court disagrees, it would probably remand the Order

to the Commission so that the Commission can attempt to resolve the statute's ambiguity. Unfortunately, the court is unlikely to consider the underlying merits of the Order and significant delay is almost certain. As these comments reflect, the Public Representative strongly believes that any delay associated with the Commission's Order could hamstring its ability to relieve the Postal Service's financial burdens.

At a minimum, the Commission should reconsider its statutory interpretation of 39 U.S.C. § 3622 and provide an alternative basis for its Order, interpreting the statutory language as ambiguous. As the Public Representative noted previously, the decision not to include an alternative basis will deprive the Commission of the benefit of *Chevron* deference. PR Initial Comments at 8. To be sure, *Chevron* deference is no panacea, but proceeding without providing an alternative statutory interpretation exposes the Commission to judicial intervention and creates a serious risk of administrative delay.

#### B. The Need for Short-Term Relief

In his initial comments, the Public Representative challenged the Commission's determination that the market dominant system has allowed the Postal Service to maintain short-term financial stability and asserted an immediate need for rate increases across all market dominant classes and products.<sup>14</sup> The Postal Service and others agree that the Postal Service lacks short-term financial stability.<sup>15</sup>

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<sup>14</sup> PR Initial Comments at 10-14. The Public Representative had previously filed a motion for reconsideration of the determination of short-term financial stability. Motion by the Public Representative for Reconsideration, January 25, 2018. The Commission denied that motion, but expressly preserved an opportunity for the Public Representative to challenge the Commission's analysis of short-term financial stability to the extent issues of law or fact relate to the Commission's proposal in Order No. 4258. Order Denying Motion for Reconsideration, February 6, 2018, at 9 (Order No. 4398).

<sup>15</sup> See e.g. Initial Comments of the United States Postal Service in Response to Order No. 4258, March 1, 2018, at 13-20 (Postal Service Comments); Comments of the National Association of Letter Carriers, AFL-CIO, March 1, 2018, at 5-9 (NALC Comments).

In an attempt to defend the Commission's finding of short-term financial stability, several commenters seek to discount the significance of declining investments and defaulted employee benefit payment obligations and seek to keep market dominant postage rates as low as possible. ANM Comments at 10-11. Their position is that no action is needed to address the Postal Service's short-term financial stability. *Id.*

As to declining investments, these commenters argue that the Postal Service has continued to make capital investments throughout the PAEA-era and that Postal Service cash reserves demonstrate that the Postal Service has the ability to fund needed capital projects. *Id.* at 42-43. They suggest further that under a price-cap, wasteful investments would be expected to decline as a matter of frugality, not forced deprivation. *Id.* at 47. These arguments ignore that the investments the Postal Service has made for years were due to defaults on its employee benefit payment obligations. See FY 2015 Form 10-K at 30; FY 2016 Form 10-K at 32; and FY 2017 Form 10-K at 36.

With respect to the Postal Service's reliance upon defaulted employee benefit payment obligations to generate cash needed for uninterrupted operations and investments, these commenters suggest that the Postal Service should ignore its payment obligations and continue to default because the Treasury Department has not insisted upon payment. ABA Comments at 11-12; Comments of the American Forest & Paper Association, March 1, 2018, at 6-7 (AF&PA Comments); ANM Comments at 47; and Comments of Quad Graphics, March 1, 2018, at 3 (Quad Graphics Comments). Indeed, ANM criticizes the Postal Service for having drawn upon its borrowing authority to make statutorily required retiree health benefit prefunding payments when it could, in the view of this commenter, simply have defaulted. ANM Comments at 47. These suggestions are patently inconsistent with the congressional expectation that the Postal Service operate like a private commercial enterprise. No private commercial enterprise would be expected to cavalierly default on its legal obligations as a means of financing its operations, whether short-term, medium-term, or long-term.



The argument that the Postal Service's employee benefit payment obligations can be left to Congress to address is equally unpersuasive. To date, Congress has made some important, but limited, progress in addressing the sources of the Postal Service's financial difficulties. House bill H.R. 756, reported out of committee during the 114<sup>th</sup> Congress, would integrate the Postal Service's retiree health benefit program with Medicare; restore one-half of the exigent rate surcharge; and require the Office of Personnel Management (OPM) to use postal-specific demographics in calculating the Postal Service's liability for the Civil Service Retirement System (CSRS) and Federal Employee Retirement System (FERS) retirement programs.<sup>16</sup> Although those changes would reduce costs for retiree health benefit and pension programs, they would not, as the Postmaster General testified during hearings of the bill, eliminate all exogenous costs associated with those programs. See PR Initial Comments at 51-55. Based upon the numbers presented by the PMG, the Public Representative calculates that the annual net exogenous costs for the retiree health benefit and retirement programs following enactment of H.R. 756 would average approximately \$3.54 billion, an amount that is likely understated.<sup>17</sup>

The suggestion that the Postal Service's employee benefit payment defaults should be left to Congress assumes, of course, that a bill with provisions comparable to H.R. 756 will be enacted into law in the relatively near future. If not, the Postal Service has stated that it is likely to continue to delay investment and default on its employee benefit obligations. See FY 2017 Form 10-K at 40. Delayed investments and continued defaults are not a proper basis for "achieving short-term financial stability." Indeed, at

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<sup>16</sup> See H.R. 746, the Postal Service Reform act of 2017 (as passed by H. Oversight and Government Reform Comm., March 16, 2017 (H.R. 756).

<sup>17</sup> *Id.* at 55. The \$3.54 billion average annual exogenous cost for retiree health benefit and retirement programs compares favorably with the annual average \$4.145 billion exogenous cost adjustment proposed by the Public Representative. *Id.* The potential for integrating the exogenous cost adjustment proposed by the Public Representative with legislative changes comparable to H.R. 756 is discussed *infra*.

some point, this short-term approach will add to medium-term and long-term financial instability.

Even if it is assumed that the solution to the employee benefit payment problem rests with Congress, that does not change the fact that unless and until Congress acts real-world consequences have been, and are continuing to be, created by these payment obligations. It is the Commission's responsibility to address those consequences unless and until Congress acts.

C. The Price Cap System Should Be Retained but Modified for Exogenous Costs and Volume Changes and for Full Cost Recovery by the Periodicals Class Rather Than for Any Partial Cost of Service Proposals that Are Without Underlying Principle, Flawed and Inadequate

1. The Public Representative's Proposal Would Retain the Price Cap with Adjustments that Differ from the Postal Service Proposals

The Public Representative supports continuation of price cap regulation with modifications in accordance with recognized price cap principles to allow for rate increases above the CPI-U for exogenous costs including volume changes as authorized by the PAEA. The recognition of exogenous factors does not circumvent the price cap. It is a recognized method under traditional price cap theory to allow a regulated entity the opportunity to recover costs that are outside of its control. The Declarations of Drs. Kwoka, Wilson, and Brennan recommend this method. During the 1997 congressional hearings regarding a predecessor of the PAEA, this method was discussed.<sup>18</sup> Dr. Kwoka employed this method during his work at the Federal Communications Commission (FCC) where he first developed price cap plans for AT&T

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<sup>18</sup> See *Hearing Before the Subcomm. on the Postal Service of the H. Comm. on Government Oversight and Reform*, 105th Cong. 33-51 (April 16, 1997) (Kwoka Congressional Testimony). Dr. Kwoka had been a member of the FCC team that drafted the AT&T price-cap regulation.

and then for local exchange carriers (LECs).<sup>19</sup> Because exogenous factors are beyond the control of the regulated company, the costs imposed by these factors are not subject to the efforts at efficiency or productivity of the regulated company.<sup>20</sup> Price cap adjustments for efficiency and productivity are therefore separate and unnecessary under the Public Representative's proposal. The Public Representative also supports full cost recovery for the Periodicals class but recognizes various factors such as rate shock and operating inefficiencies suggest rates below full cost may be necessary, as discussed below.

The Postal Service's first preference is to abandon price cap regulation altogether. Postal Service Comments at 32-48. The Public Representative has previously expressed the view that the Commission does not have unfettered authority to fashion new rules modifying the price cap. Any new rules must be grounded upon reasonable support. PR Initial Comments at 7. Abandoning price cap regulation would be unwise.

In the alternative, the Postal Service requests a level of additional supplemental rate authority if it produces a compensatory baseline rate derived primarily from past losses with adjustments. *Id.* at 56-69. It, as well as several other commenters and the Commission's proposal, essentially argue for an abbreviated or partial cost of service rate adjustment to permit an increase in rates amounting to losses for a single year in an effort to recover total costs.<sup>21</sup>

The Postal Service has characterized its position as seeking additional rate authority that would reset rates "to a reasonably compensatory level based on prior representative financial results" with an allowance "for reasonable adjustments to the

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<sup>19</sup> Kwoka Decl. at 2.

<sup>20</sup> *Id.* at 8.

<sup>21</sup> However, the Postal Service would delete non-cash adjustments from the net loss calculation. *Id.* at 59.

CPI-based formula to account for factors outside the Postal Service's control that would significantly alter the reset rates' contribution yield." USPS Response to Motion, March 1, 2018, at 3. However, certain exogenous factors relied upon by the Postal Service differ from those upon which the Public Representative relies. They are inconsistent with the recommendations of Drs. Kwoka and Wilson and Dr. Brennan who have years of experience writing about and formulating workable price caps.

The Postal Service would adjust its FY 2017 loss for non-cash workers' compensation resulting in a net loss in FY 2017 of \$5.0 billion. Postal Service Comments at 58-59. This yields an absolute minimum \$5.0 billion loss or, using the Commission's calculation method, annual supplemental rate authority of 3.3 percent. *Id.* at 60. The 5 year average loss from FY 2013 to FY 2017 was \$5.7 billion or, with the Commission's method of calculation, a 3.8 percent additional rate authority. *Id.* at 62. Removing the impact of the exigent surcharge and adjustments for postage in the hands of the public (PIHOP), its final 5-year average loss is calculated as a \$6.0 billion loss or, under the Commission's formula, a 4.0 percent supplemental rate authority each year for five years. *Id.* at 63.

The Postal Service estimates efficiency gains could reduce this required amount by, at best, \$0.8 billion in annual cost savings.<sup>22</sup> This conclusion is based on the A&M report assessing the Postal Service's operations that concludes the opportunities for further cost savings do not come close to filling the Postal Service's net-income gap. *Id.* at 66. In any event, the Postal Service believes the Commission's proposal will not nearly achieve medium-term stability. Postal Service Comments at 68.

However, the Postal Service tempers its cost of service alternative with adjustments for essentially exogenous factors that it claims materially impact its ability to achieve the expected net losses. *Id.* at 69-80. The Public Representative concurs

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<sup>22</sup> *Id.* at 65-66; Alvarez and Marsal (A&M) report.

with the Postal Service about the need for rate adjustments for changes in pension and retiree health benefit payments. *Id.* at 74-77. But, the Public Representative disagrees that the adjustments should be made to a baseline cost of service that amount to nothing more than total re-initialization by a partial cost of service calculation that accepts the Postal Service's book figures (without adjustments and without the roll-forward adjustments previously applied during the pre-PAEA era).

On the other hand, unlike the Postal Service, the Public Representative's proposal does not start with the most recent financial loss but only adds to the current CPI-U adjustment rates those changes in exogenous costs which management cannot control. The Postal Service also attempts to fine-tune the impact of cost changes. It would adjust for other costs that affect the coverage of institutional costs, such as changes in the mail mix and the delivery network. *Id.* at 71-74. However, changes in mail mix and delivery networks are not factors that are clearly beyond management's control and those adjustments would not be supported by the Public Representative.

Like the Public Representative, the Postal Service finds that the 1 percentage point for performance-based standards is inadequate for the purpose for which it is proposed. *Id.* at 81; PR Initial Comments at 32.

## 2. The Flawed Abbreviated Cost of Service Proposals are Not Based on Principle and Result in an Inadequate Cost Recovery

Unlike the Public Representative's principled proposal to consider exogenous factors, including volume declines, the Commission's suggested plan and those of the several commenters offer essentially partial cost of service solutions based upon past losses but with various adjustments. They lack a guiding principle and erroneously fail to account for the current and future changes in obligations to pay for exogenous factors like pension and health benefit payments and volume declines that are, by all accounts, the two factors most responsible for the Postal Service's financial straits.

The arguments of those who favor the partial cost of service approach can be analogized to arguments presented when a price cap system is initialized from cost of service levels. Prices should be initially set at average total costs to cover both the variable and fixed costs per unit associated with the on-going operation of the firm. Kwoka Decl. at 6. Setting the price with a full-blown investigation to determine the right price complicates matters greatly. *Id.* at 7. In practice, price is often simply set at the existing level at the time of plan initialization. *Id.* at 7; *see also* Kwoka/Wilson Decl at 8. In this case, prices were initialized at levels that did not contemplate either the mandatory refunding costs or the large and persistent decline in mail volumes. Kwoka Decl. at 25. A full-blown cost of service rate case is not being suggested by most commenters,<sup>23</sup> nor is reversion to a full-blown rate case desirable or necessary.

Some commenters support the Commission's proposal in Order No. 4258 for a substantially drawn-out partial cost of service reset proposal with additional performance-based rate authority. The performance-based rate authority consists of components that are, operationally, efficiency-based and service quality-based. Some commenters, for instance NALC and APWU, support the Commission's proposal with additional revisions to allow the Postal Service additional rate authority above CPI-U. The Public Representative opposes the Commission's partial cost of service method for granting such supplemental rate authority. PR Initial Comments at 15-20. The Public Representative opposes the methodologies proposed by NALC and APWU or the Postal Service's alternative method as variants of the Commission's approach.

NALC offers a more extreme example of the Commission's abbreviated cost of service method based on a single year's losses. NALC would do a full evaluation of costs to true-up the rates and would eliminate the CPI-U. NALC recognizes the need to give paramount consideration to Objective 5. NALC Comments at 3. It cites many of

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<sup>23</sup> NALC recommends a "true-up" rate case. Comment of the National Association of Letter Carriers, AFL-CIO, March 1, 2018, at 1, 15, 17 (NALC Comment).

the concerns of the Public Representative regarding the negative impacts of the PAEA on the Postal Service in the last ten years where the Postal Service has been unable to achieve financial stability. *Id.* at 2. The price-cap has led to inadequate revenue generation thereby inducing the strategy of saving money by reducing service standards, cutting Post Office hours, eliminating collection boxes, and the significant reduction in new investment including delaying replacement of an aging vehicle fleet. *Id.* at 2-11.<sup>24</sup>

NALC would eliminate the CPI-U price cap with a “true up” rate case. NALC Comment at 1, 15, 17. While this may get the Postal Service back on track, the Public Representative believes that it is not necessary to undertake a major reset at this time, much less eliminate the CPI-U.<sup>25</sup> Adjusting for exogenous costs as the Public Representative proposes is a much simpler method of calculating the necessary additional rate authority.

APWU accepts the Commission’s baseline of \$2.7 billion as a starting point for supplemental rate authority, but believes that would be insufficient to put the Postal Service on a solid financial footing.<sup>26</sup> It also opposes spreading the rate authority evenly over five years as compounding the problems of the low \$2.7 billion target. *Id.* at 11. A based on the history of volumes during the exigency surcharge period, APWU

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<sup>24</sup> These shortcomings are echoed in the report attached to NALC’s Comments concluding that the Postal Service needs to increase market dominant prices above inflation to break even and to attain financial stability, a margin over breakeven of about 5.0 percent of sales is needed. *Id.* at 5.

<sup>25</sup> NALC presents an interesting alternative to the CPI-U, the CPI for Delivery Services. (CPI-DS). *Id.* at 12. Looking backward, that index would have worked particularly well in lieu of the CPI-U. It would have permitted rate increases in line with private sector delivery companies with an increase from 2006 to 2016 of 60.7 percent compared to a CPI-U increase over the same period of 19.6 percent. *Id.* at 13-14. It does not propose the CPI-DS as a substitute for the CPI-U because private delivery service companies do not have a universal service obligation and their costs differ from the Postal Service. NALC submits that no price cap is appropriate. *Id.* at 15.

<sup>26</sup> Comments of the American Postal Workers Union, AFL-CIO on the Notice of Proposed Rulemaking for the System for Regulating Rates and Classes for Market Dominant Products, March 1, 2018, at 7 (APWU Comments).

does not believe the impact of supplemental rate authority will have the anticipated negative impact on mail volume. *Id.* at 11. It points out that permitting additional rate authority is not the same as the Postal Service actually using that authority. APWU does not believe the Postal Service will pursue suicidal rate increases. *Id.* at 12. Because of the insufficiency of the Commission's proposed supplemental authority, APWU contends a higher revenue target is necessary for both medium-term and long-term financial sustainability goals. *Id.* at 9, 12.

APWU applies the same erroneous approach as applied in the Commission's methodology by casting into the Postal Service's net loss figures, and hooks onto the average annual net loss over 10 years of \$4.8 billion, equivalent to a one-time 5 percent rate increase. It suggests slightly frontloading that amount over 5 years with declining amounts to ease rate shock. *Id.* at 13. Just as the Public Representative has responded to others who recommend supplemental rate authority tied to past losses, the Public Representative contends APWU's proposal is likewise an unsatisfactory and inefficient method for supplemental rate increases to fill the Postal Service's creel.

APWU correctly points out problems with the Commission's proposed performance-based rate authority. For instance, it demonstrates the incentive level is probably impossible to meet. *Id.* at 14-17. Unlike some, APWU would offer a rate allowance directed toward the real purpose of the Commission's TFP incentive: to provide funds for investment. Thus, APWU would offer rate authority to the Postal Service for simply "outlining capital outlay and investment plans in its rate case that the additional rate authority would be used to fund." *Id.* at 19. While the Public Representative does not believe these additional incentives are required if the exogenous costs are specifically included in rates as proposed, the APWU suggestion appears to be a superior solution to the performance-based incentive in Order No. 4258.



The National Postal Mail Handlers Union (NPMHU) argues the Commission's methodology yields too little revenue to achieve medium-term stability and that there is no question the Postal Service requires some additional rate authority.<sup>27</sup> It does not support any particular approach to increase revenue and does not rule out the Public Representative's method that would permit the Postal Service to recover pension and health benefit costs that are burdening the Postal Service.

D. Contrary to Some Comments, Competitive Products Should Not Be Required to Make-up 29 Percent of Postal Service Losses

1. The Contentions of GCA, ANM and NPPC

The Greeting Card Association (GCA), ANM and the National Postal Policy Council (NPPC) contend that Order No. 4258 is erroneous in charging market dominant customers with the entire burden of the FY 2017 loss of \$2.7 billion. GCA relies on a report attached to its Comments by NDP Analytics for its proposed treatment of contribution by competitive products. GCA Comments at 10. GCA contends that contribution to revenue by the competitive sector should be recognized in determining the size of the proposed supplemental allowance for Postal Service rates. *Id.* Likewise, NPPC contends that it would be reasonable to reduce the shortfall to be recovered by market dominant mail by 30 percent to reflect the share of total Postal Service revenues generated by competitive products. NPPC at 54-55. Scenario 1 of GCA's NDP Report assumes the financial contribution needed to cover the deficit should be proportional to the current shares of revenue from market dominant products and competitive products. ACA Appendix at 1. GCA advocates allocating the loss between the market segments at 71 percent for market dominant products and 29 percent for competitive products.

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<sup>27</sup> Comments of the National Postal Mail Handlers Union, March 1, 2018, at 4 (NPMHU Comments).

This would drop the Commission's proposed market dominant rate allowance of \$2.7 billion to \$1.9 billion. GCA Comments at 10.

## 2. The GCA, ANM and NPPC Proposal Fails on Several Counts

The GCA, ANM and NPPC proposal fails for several reasons. First, they do not recognize that the Postal Service's financial statement already included a contribution from competitive products. They do not take into consideration that the loss itself included contribution to total institutional costs from competitive products of 23.2 percent in FY 2017. The contribution of institutional costs actually recovered, *i.e.* calculated by subtracting the \$2.7 billion loss from total institutional costs) is even greater than 23.2 percent. That is a large part of the 29 percent GCA would apportion. GCA Comments, Table B at 6 Competitive products are already contributing substantially to the bottom line and that contribution prevents larger losses. Presumably, the Postal Service is pricing its competitive products as high as the market will bear. To essentially require the Postal Service to increase competitive prices to recover part of the shortfall as GCA and others suggest is to remove the Postal Service management's prerogative to price competitive products as it sees fit.

Second, GCA and NPPC assume (without any supporting argument) that the appropriate allocation for competitive products' contribution toward recovering booked losses for FY 2017 should be the relative revenue contribution of competitive products to total revenue, *i.e.* 29 percent. This revenue method for apportioning institutional costs to be covered by competitive products has been soundly rejected by the Commission three times. It was first rejected in 2007.<sup>28</sup> Then again, upon the first five-

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<sup>28</sup> Docket No. RM2007-1, Order Proposing Regulations to Establish a System of Ratemaking, August 15, 2007 at para 3050 (Order No. 26), see *also*, Docket No. RM2012-3, Order Reviewing Competitive Products' Appropriate Share Contribution to Institutional Costs, August 23, 2012 at 11-12, 25 (Order No.1449).

year review in 2012, the Commission rejected UPS' assertion that the Commission should use competitive revenue as a basis to make up for reduced market dominant contributions.<sup>29</sup> Recently, during the second five-year review, UPS again argued the Commission should use, as its alternative to its first choice of using the proportion of attributable costs, the proportion of revenue shares between competitive products and market dominant products.<sup>30</sup> Thus, the Commission has not expressed any inclination to allocate total institutional costs between market dominant and competitive products based on their proportionate revenue.

In the three cases above, the Commission acted pursuant to § 3633(a)(3) to “ensure that all competitive products collectively cover what the Commission determines to be an appropriate share of the institutional cost of the Postal Service.” In the first two cases, based primarily on historical contribution, the Commission determined that 5.5 percent of institutional costs is the appropriate minimum share of institutional costs to be contributed by competitive products. In the most recent rulemaking, the Commission has proposed a formula that would yield an allocation of institutional costs to competitive products for FY 2017 of 7.8 percent.<sup>31</sup> That case remains subject to comment by interested persons on or before April 16, 2018. The 23.2 percent contributed by competitive products in FY 2017, easily complied with either of those minimum requirements established by the Commission.

Third, GCA erroneously contends the rulings in § 3633(a)(3) do not apply here. GCA at 13-19. It argues that Objective 9 in § 3622(b)(9) operates separately from § 3633(a)(3) despite the Commission's statement in Order No. 4258:

[T]he Commission determines that although the mechanism for allocation is located outside of section 3622, the statutory and

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<sup>29</sup> Order No. 1449 at 5, 25.

<sup>30</sup> Docket No. RM2017-1, Notice of Proposed Rulemaking to Evaluate the Institutional Cost Contribution Requirement for Competitive Products, February 8, 2018 at 77, 81-82 (Order No. 4402).

<sup>31</sup> Order No. 4402, Table IV-7 at 52.

regulatory mechanisms to set the allocation of institutional cost required by section 3633(a)(3) and 3633(b) provide a mechanism to appropriately allocate institutional costs between competitive and market dominant products. Order No. 4257, at 246-247.

GCA requests the Commission to affirm that Objective 9 has an independent role and may be invoked to require reallocation of institutional costs between the competitive and market-dominant sectors even if the minimum share established pursuant to section 3633(a)(3) is being contributed or exceeded. GCA at 19.

GCA rightly points out the allocation in question is governed by Objective 9. Section 3622(b)(9)) provides that one of 9 Objectives of the PAEA is, “To allocate the total institutional costs of the Postal Service appropriately between market dominant and competitive products.” GCA relies on a theory of statutory interpretation that if two similar sections are included in a statute, their purpose must be distinct from each other. GCA at 14-16. From this, GCA concludes the minimum allocation allowed under § 3633(a)(3), 5.5 percent (39 CFR § 3015.7(c)), is not the same allocation to be applied for Objective 9. While this may be true, and the sections may apply in different circumstances, it does not follow that the “appropriate” allocation for purposes of applying § 3622(b)(9) should be one based on revenue.

In fact, the two sections are operating independently for different types of proceedings. It does not follow that the Commission is in error by looking to its policy determination under § 3633(a)(3) when deciding how to improve the system of ratemaking under § 3622(b)(9) to enable the Postal Service to meet the Objectives of the PAEA. With regard to competitive product costs, each section includes the phrase “appropriate.” In § 3633(a)(3) it is “cover an appropriate share” and in § 3622(b)(9) it is,

“allocate...appropriately.” The allocations are administered independently for difference purposes, but, in each case, the allocation is to be appropriate.<sup>32</sup>

The competitive products contributed 23.2 percent of institutional costs in FY 2017. GCA Comments, Table B at 6. That amount complies with the policy of § 3633(a)(3) because it meets or exceeds the 5.5 percent amount (as well as the new minimum proposed in Order No. 4402 for FY 2017 of 7.8 percent) that the Commission has determined is “an appropriate share of the institutional costs of the Postal Service.” In this proceeding, the Commission is considering the appropriate allocation of costs under Objective 9. It is only one consideration among nine objectives and many factors.

There is no logic to reducing the market dominant supplemental rate allowance based on the hope that competitive products will contribute to institutional costs to the extent of their proportionate revenue of approximately 30 percent. There is no showing the competitive products can, or are likely to, achieve that level of contribution. The result of such an assumption is to build a shortfall into the market dominant rates that will virtually guarantee the Postal Service will not reach medium-term stability unless in the very near future competitive products contribute 29 percent or whatever their revenue share is in the applicable year. In essence, the appropriate share under § 3622(b)(9) should be the level of recent earnings contributed by competitive products, but subject to the minimum requirement policy established by application of § 3633(a)(3).

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<sup>32</sup> GCA is concerned that if the Commission finds the minimum under § 3633(a)(3) to be zero as some participants have proposed in Docket No. R2017-1, then all competitive products could be priced at attributable costs without contributing anything to institutional costs. GCA at 12. This concern merely proves the point that these sections are administered independently. Suppose the minimum allowed contribution under § 3633(a)(3) is set at zero to provide flexibility to the Postal Service for pricing its competitive products. Nevertheless, the contribution to institutional costs in a rate proceeding, or in a review such as this, to ensure that Objective 9 and other Objectives are balanced, would not necessarily fall to zero, but would reflect the actual contribution of competitive products in the profit and loss statement of the Postal Service.

### 3. Using Historical Growth Trends of Competitive Products to Assume Future Growth in their Contribution is Not Appropriate

GCA's NDP report reflects a second assumption. It uses historical growth trends of competitive products to estimate future growth in competitive revenue. The example in the report assumes competitive sector revenue will grow at only one-half the experienced rate (6.4 percent rather than 12.9 percent) and that the competitive share of attributable costs will remain constant. *Id.* at 10. This would reduce the required rate increases under the Commission's Order No. 4258 from \$2.7 billion to only \$1.0 billion. *Id.* at 10-11. ANM also suggests reflecting the projected contribution from competitive and market dominant products growth. ANM at 73. As desirable an outcome for market dominant rates that this produces, it is untenable.

Anticipated contributions from competitive products should not be a basis for determining an appropriate share for purposes of establishing supplemental rates. Using growth trends is inappropriate for establishing the level of rate increases in this environment. Future growth should not be taken into account for one income stream but then not considered for other revenue streams or for costing streams. In certain cases, future annual adjustments for CPI-U or volume declines may be allowed for future factors pending the commencement of the 3-year or 5-year review as the case may be. Any adjustment should be based on recent performance; not estimated future performance. This will keep adjustments to the price cap to a minimum more easily computed, and help to maintain rate predictability and stability.

Indications are that the contribution from competitive products will continue to increase in the future. To the extent the contribution increases, the Postal Service's losses will decline and improve the opportunity for eliminating operating losses and possible earn profit on operations.

E. The Public Representative Gives Appropriate Consideration to All Objectives and Factors

In this section, the Public representative addresses arguments presented by opponents of the Commission's proposed modification to the current market dominant system that have potential implications for the Public Representative's positions.<sup>33</sup> The Public Representative first addresses contentions that the Commission and the Public Representative have improperly relied upon Objective 5 as a basis for concluding that modifications to the current system are necessary. Next, arguments are addressed that those proposals violate the remaining objectives. For the reasons given below, the Public Representative submits that his proposed modifications to the current system are consistent with all of the statutory objectives.

1. Objective 5 (assure adequate revenues and maintain financial stability).

In Order No. 4257, the Commission found that Objective 5 had not been achieved. That conclusion was based on findings that although short-term financial stability had been achieved, medium-term financial stability and long-term financial stability had not. As discussed in section III.B., above, the Public Representative agrees with the overall finding that Objective 5 is not being achieved, but takes the position that short-term financial stability, as well as medium-term and long-term financial stability, is not being achieved.

The difference between the Commission's and the Public Representative's position on the question of short-term financial stability is of more than academic

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<sup>33</sup> Those attacks focus exclusively on the Commission's proposals and do not address the Public Representative's positions. Some arguments apply solely to the Commission's proposals. For example, ANM attacks the Commission's reliance upon the "harmonious cycle" in its analysis of Objective 1. ANM Comments at 41-48. The Public Representative does not rely on the harmonious cycle. Other arguments can, however, be interpreted as applicable to the Public Representative's positions. These latter arguments are addressed in this section.

interest. As the Commission itself recognizes, short-term financial stability, medium-term financial stability, and long-term financial stability are related. Order No. 4257 at 159. Consequently, short-term financial stability can impair medium-term financial stability, which can, in turn, impair long-term financial stability. That is what has happened here. Each year during the past 10 years, the financial stability of the Postal Service has continued to degrade as revenues continued to fall short of the Postal Service's needs. As this has occurred, short-term instability has extended its reach to the medium-term and long-term. The result has been a failure to achieve Objective 5 in all three terms—the short-term, the medium-term, and the long-term. This failure to achieve financial stability adversely affects the achievement of other statutory objectives: Objective 3 (the maintenance of high quality service standards), Objective 4 (allowance of the Postal Service to exercise pricing flexibility), and Objective 8 (the establishment of just and reasonable rate schedules). See PR 2017 Comments at 21. It also adversely affects Objective 1 (maximize incentives to reduce costs and increase efficiency). *Id.*

Opponents of the Commission's proposals in Order No. 4258 attack the Commission's finding that Objective 5 has not been achieved by asserting that the Postal Service's financial difficulties are largely, if not entirely, the Postal Service's fault and not the result of shortcomings in the current market dominant system. They suggest that the Postal Service is financially stable in the short-term, the medium-term, and the long-term. ANM Comments at 71-82. They claim that the Commission has violated § 3622(b) by failing to balance consideration of Objective 5 with the other statutory objectives. *Id.* They argue that the Commission's proposed modifications to the current market dominant system violate specific statutory objectives. For the reasons that follow, the Public Representative disputes these assertions and submits that Objective 5 is not being achieved; that its significance has not been overemphasized; and that the alleged violations of other statutory objectives do not apply to the Public Representative's proposed changes to the current system.



*Financial stability.* Commenters agree with the Commission's conclusion that the current system has achieved short-term financial stability, but challenge the Commission's findings of medium-term and long-term financial stability. In doing so, they suggest that the Postal Service can disregard its obligations to make prefunding payments into the retiree health benefit fund, in part, because Congress and the Administration have taken no action to enforce compliance; that the Postal Service's employee benefit programs are already better funded than the vast majority of public and private sector programs; and that the Commission should focus on how much money the Postal Service will need to meet present and future obligations to its retirees. *Id.* at 6, 76-77, 109. These commenters go so far to allege that the Postal Service "has squandered its borrowing authority" by making prefunding payments and that "it was foreseeable that the Postal Service could stop making the prefunding payments without a penalty—as has in fact occurred." *Id.* at 47.

The suggestion that the Postal Service and the Commission should cavalierly disregard the Postal Service's legal obligation to make retiree health benefit program payments is astonishing. It also stands in stark contrast to the absolute sanctity accorded to the CPI-U price cap by these commenters.

While it is understandable that the Postal Service would consider defaulting on its obligations to make these payments as a matter of business necessity, that does not justify suggestions that these obligations are legally optional. With regard to the suggestion that the Postal Service can assume no future attempts will be made to enforce compliance with these obligations, it should be noted that the Office of Personal Management has not ruled out the possibility that a payment plan may yet be required. See FY 2017 Form 10-K at 55. And the suggestion that the Postal Service's benefit plans are already adequately funded and require no further funding is a suggestion more properly made to Congress than the Commission.

The fact is that the continuing inability of the Postal Service to make these employee benefit program payments and meet its other obligations is not only relevant to the issue of short-term financial stability, but provides compelling evidence of short-term financial instability, as well as the medium-term and long-term financial instability that flow from the mounting effects of that short-term instability. That conclusion finds further support in Postal Service projections with and without legislation that would change the Postal Service's obligations to make retiree benefit program payments. See PR Initial Comments at 52-55.

In an attempt to divert attention from the failure of the current market dominant system to achieve Objective 5, several commenters assign blame to the Postal Service for doing “*nothing* to reduce its massively inflated costs or take advantage of the alternative sources of revenue and cost savings....” ANM Comments at 64 (emphasis added). The Postal Service, like any business, makes mistakes. However, it cannot be fairly accused of doing *nothing* to reduce costs and increase revenues.<sup>34</sup> Indeed, efforts by the Postal Service have contributed to a reduction in the quality of its service. PR 2017 Comments at ^^. As Drs. Kwoka, Wilson, and Brennan have noted in their declarations, price cap regimes have the potential for incentivizing declines in service quality in order to stay within price caps. *E.g.* Kwoka Decl. at 10-11.

Even if the Commission were to accept suggestions that the Postal Service's financial situation is the result of its failure to more aggressively to control costs or to pursue additional revenues, the examples offered by commenters do not overcome the conclusion of the current system's failure to achieve Objective 5 and the need to address that failure. For example, commenters suggest that the Postal Service should oppose the overpayment of postal workers in wage arbitration proceedings with its

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<sup>34</sup> See, e.g., NALC Comment at 7-8; Docket No. PI2016-3, Public Representative Comments, June 15, 2016, at 20-26.

unions. ANM Comments at 77. However, it appears from the arbitrator's decision cited by ANM in its 2017 comments<sup>35</sup> that the Postal Service had aggressively opposed union wage demands.<sup>36</sup>

Second, commenters suggest that the Postal Service has been remiss in not reviving cost reduction efforts discontinued in FY 2014. ANM Comments at 77. In their earlier comments in 2017, however, they concede that, "the network rationalization plan has not been without its challenges", and in a footnote acknowledge that Phase 2 of the program was halted "in large part because of detrimental impacts on service." ANM 2017 Comments at 53. It also urges the Postal Service to consider greater use of curbside and centralized mailboxes. *Id.* at 54. However, it concedes that these delivery options may not be suitable for all locations. *Id.*

Third, these same commenters suggest that the Postal Service abandon its Flats Sequencing System (FSS) and make better pricing decisions. ANM Comments at 77. In earlier comments, the Public Representative acknowledged the Commission's ongoing investigation of issues relating to FSS operations. PR 2017 Comments at 16-22. The Public Representative supports that investigation and any cost saving measures that are found to be necessary at the conclusion of the Commission's inquiry. *Id.* However, the outcome to that investigation would not appear imminent and, given the Postal Service's short-term financial instability, does not appear to afford cost reductions likely to remediate that instability. With respect to pricing decisions, the Public Representative agrees that better pricing decisions should be made. However, there has been no convincing showing that such decisions will overcome the Postal Service's short-term financial instability.

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<sup>35</sup> Comments of Alliance of Nonprofit Mailers, Association for Postal Commerce, and MPA—The Association of Magazine Media, March 20, 2017, at 50 (ANM 2017 Comments).

<sup>36</sup> See *In the Matter of USPS and APWU, AFL-CIO*, Interest Arbitration Decision and Award, July 8, 2016, at 11.

Finally, commenters assert that the Postal Service should investigate new revenue sources. ANM Comments at 77. In earlier comments, these commenters identify are market dominant negotiated service agreements (NSAs) and rental advertising on mail trucks. ANM 2017 Comments at 57-59. With respect to market dominant NSAs, the Postal Service has lost significant amounts of money.<sup>37</sup> With respect to possible advertising revenues, commenters cite an annual revenue estimate of approximately \$360 million. ANM 2017 Comments at 59. The Public Representative supports Postal Service efforts to find additional sources of revenue, but submits that the projected revenues from the sources identified by commenters will not solve the Postal Service's short-term financial instability problem.

*Failure to balance objectives.* Opponents of the Commission's proposals also assert that the Commission has violated the requirement that each statutory objective in section 3622(b) "shall be applied in conjunction with the others." ANM Comments at 29-30. They assert that the Commission has failed to strike the right balance by gearing its proposal toward a single goal, the achievement of Objective 5. *Id.* at 29-31. The Public Representative, like the Commission, has focused on the failure of the current market dominant system to achieve Objective 5 because of its importance and because of the role it has played in the Postal Service's failure to achieve other objectives. PR 2017 Comments at 16-22.

Commenters are wrong in asserting that the Commission and the Public Representative have improperly elevated Objective 5 above all other objectives. Congress has left to the Commission the authority to determine which objectives, if any, the market dominant system is failing to achieve and what modifications, if any, should be made to the system. In doing so, Congress has not prescribed specific weights to be

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<sup>37</sup> FY 2011 Annual Compliance Determination at 152 (Bradford Group NSA and Lifeline NSA); FY 2014 Annual Compliance Determination at 59 (Discover NSA); FY 2015 Annual Compliance Determination at 75 (Valassis NSA); and FY 2017 Annual Compliance Determination at 47 (PHI NSA). Together, these five NSAs have lost over \$25 million.

given to individual objectives. Nor has it prescribed a formula for the Commission to follow. Instead, the Commission is free to determine the significance to be accorded to the objectives, individually and collectively, in the specific factual circumstances presented. As long as the Commission applies the objectives “in conjunction with” each other and observes other applicable statutory and legal requirements,<sup>38</sup> it can, in specific circumstances decide that remedial action is necessary in order for the system to achieve the statutory objectives. The only other limitations that the Commission must observe are the generally applicable legal requirements that it engage in reasoned decision making and that its findings be supported by the record.

In this proceeding, the information presented to the Commission demonstrated that Objective 5 was not being achieved. PR 2017 Comments at 18-22. To support that assertion, the Public Representative relied upon: losses of over \$56 billion incurred by the Postal Service since enactment of the PAEA driven in significant part by the PAEA’s requirement that the Postal Service make \$5 billion annual payments into the retiree health benefit fund; the Postal Service’s default in making those prefunding payments; the exhaustion of the Postal Service’s borrowing authority; significant declines in mail volume that are projected to continue to grow and generate more revenue declines; the adverse impact on the achievement of Objective 3 (maintenance of high quality service standards), Objective 8 (the establishment and maintenance of just and reasonable rate schedules), and Objective 1 (maximization of incentives to reduce costs and increase efficiency). *Id.*

The Public Representative submits that there is adequate record support for the Commission’s determination that Objective 5 is not being achieved; that the importance of addressing the system’s failure to achieve Objective 5 is not excessive; and that an

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<sup>38</sup> Included is the list of statutory requirements relied upon by ANM are the provisions in § 3622(d) that limits changes in the price cap to changes in the CPI-U. Arguments regarding the CPI-U are considered below.

emphasis on addressing Objective 5 can be accomplished “in conjunction with” other statutory objectives.

*The Public Representative’s Recommendations.* The Public Representative has proposed modifications to the current market dominant system that address impediments to the achievement of Objective 5 and, if adopted, would alleviate adverse impacts on other statutory objectives flowing from the failure to achieve Objective 5. The proposed changes would give the Postal Service additional rate authority. The recommended changes are targeted at the principal causes of the system’s failure to achieve Objective 5. Those causes were, and continue to be, the imposition of exogenous employee benefit costs; the continuing decline in mail volume driven by exogenous factors, such as changing demographics and consumer preferences; and the price cap applicable to the Periodicals Class that denies the Postal Service the opportunity to improve recovery of its costs. PR Initial Comments at ^.

The Public Representative’s proposals are supported by the sworn declarations of experts with extensive experience with price cap theory and its application. Drs. Kwoka and Wilson advocate an adjustment to the price cap to permit recovery of exogenous costs. Kwoka/Wilson Decl. at 5-6. Dr. Brennan endorses an adjustment to the price cap for declines in mail volume due to exogenous factors. Brennan 2017 Decl. at 13-15; Brennan Supp. Decl. at 1-2. Drs. Kwoka and Wilson recommend increasing the price cap applicable to the Periodicals Class to permit recovery of 100 percent of costs. Kwoka/Wilson Decl. at 15-17. Dr. Lyudmila Bzhilyanskaya from the Commission Staff has provided rate analyses and other information in support of the Public Representative’s submissions.

Opponents of the Commission’s proposals have alleged that those proposals not only do not balance the statutory objectives, but actually violate certain objectives. In the sections that follow, the Public Representative demonstrates that the changes to the

current system advocated by the Public Representative are consistent with the remaining statutory objectives.

2. Objective 1 (maximize incentives to reduce costs and increase efficiency).

In Order No. 4257, the Commission found that the current market dominant system did not “maximize incentives to reduce costs and increase efficiency.” Order No. 4257 at 222. It based that decision on the fact that increases in Total Factor Productivity (TFP) and decreases in costs had not adequately addressed the Postal Service’s financial instability because they had not permitted the Postal Service to generate retained earnings. *Id.* In Order No. 4258, the Commission attempts to increase the Postal Service’s revenues to generate retained earnings that can be used for investments that will reduce costs and increase efficiency. See Order No. 4258 at 39-73, 47, Figure III-2, “Financial Health Cycle.”

The Public Representative has not taken a position on whether the current system is achieving Objective 1, but has recognized that the failure to achieve Objective 5 has had an adverse effect on Objective 1. See PR 2017 Comments at 21, 26-28. Nevertheless, some of ANM’s comments arguably have implications for the Public Representative’s recommended changes to the current market dominant system and therefore requires a response.

The Public Representative has proposed adjustments to the price cap to reflect costs associated with exogenous factors. Such factors include employee benefit program costs and declines in demand due to factors like changes in demographics. ANM appears to agree. See ANM Comments at 35 (“incentives to reduce cost focuses on factors within the Postal Service’s control”). Costs associated with exogenous factors are beyond the Postal Service’s control. As such, these costs do not implicate Objective 1 and the maximization of incentives to reduce costs and increase efficiencies

do not affect the Postal Service's ability to pay the costs of exogenous factors. Kwoka Decl. at 8.

Objections by ANM and others<sup>^</sup> that adjustments to the price cap would undermine incentives to reduce costs and increase efficiency could also be directed at the Public Representative's recommendation that the price cap applicable to the Periodicals Class should be adjusted to compensatory levels. *E.g.* ANM Comments at 39. Because adjustments to the Periodicals Class price cap would give the Postal Service the authority to recover costs that are subject to Postal Service control and efficiencies, the issue of whether, and to what extent, additional price cap rate authority for the Periodicals Class would affect Objective 1 incentives for cost reduction and efficiency improvements is a potentially proper subject for Commission review. The Commission should therefore review that issue in this proceeding as part of an adjustment to the Periodicals Class price cap.

Finally, in determining whether an upward price cap adjustment for the Periodicals Class will undermine the achievement of Objective 1, the Commission must not fail to consider incentives for reducing costs and increasing efficiency other than the price cap itself. For example, the need for restoration of the Postal Service's borrowing authority will continue to provide an incentive for cost reductions and increases in efficiency even if the price cap is adjusted. The Postal Service's need for funds for investment and contingencies, such as economic recessions, will also provide continuing incentives for controlling costs and increasing efficiencies in order to make funds available for such purposes. See FY 2017 Form 10-K at 36.

Other arguments advanced by ANM are unpersuasive. For example, ANM argues that, "[l]oosening the regulatory price cap necessarily weakens the incentives it provides." *Id.* at 39. A strict application of this proposition would prevent adjustments to correct design defects in price cap regimes. However, as Dr. Kwoka states in his declaration, the correction of design defects in price cap systems is well-established.



Kwoka Decl. at 11-12; Kwoka/Wilson Decl. at 4. Under established price cap principles, the correction of defects is not precluded by the possibility that such corrections would weaken incentives for cost control or efficiency improvements. Incentives based on a defective price cap system are perverse incentives never intended as a justification for price cap regulation.

ANM also argues that retained earnings generated by additional rate authority are not needed to fund capital projects “as long as it [the Postal Service] is meeting the definition of *short term* financial stability.” ANM Comments at 43 (italics in the original). This “short-term financial stability” is, as discussed above, illusory, being based, at least in part, on Postal Service defaults in employee benefit payment obligations.

3. Objective 2 (rate predictability and stability).

*Predictability.* All three of the price cap adjustments proposed by the Public Representative can be implemented in ways that are predictable. Exogenous costs (retiree health and pension benefit payments) are projected to remain relatively constant over the next five years. See PR Initial Comments at 49-54, Tables 4 – 8. These adjustments could be made as a one-time adjustment (subject to minor changes annually) or could be phased in over a period of years. See PR Initial Comments at 47-50. In either case, the adjustments to the price cap for these costs would be predictable.

Adjustments to the price cap for declining demand due to exogenous factors would also be predictable. Each January, the projected adjustment to the price cap for each mail class would be available for the following calendar year. The projected adjustment would be based on information filed every January by the Postal Service in the Postal Service Econometric Estimates of Demand Elasticity for All Postal Products. As described in the discussion of Objective 6, below, the Commission can publish on its website the projected adjustment for changes in demand and can provide interested persons the ability to generate their own estimates.

The adjustment to the price cap for the Periodicals Class to achieve full cost recovery could be a one-time adjustment or it could be phased-in over a period of years. In either case, the adjustment(s) would be predictable. Each year, the adjusted cap would be subject to further adjustments for changes in the CPI-U, as is currently the case.

*Stability.* ANM asserts that, “[r]ates are stable within the meaning of Objective 2 if they hold constant after adjusting for inflation.” *Id.* at 58. It supports this position with citations to Commission orders, pronouncements by officials of the Federal Reserve Board and other central banks, and selected references to legislative history. *Id.* at 58-61. Each of these arguments is just another form of ANM’s contention that the CPI-U adjusted price cap is immutable.

ANM cites Order No. 547 to support the proposition that “[t]he Commission has held repeatedly that ‘rate stability’ means that average prices for a class do not increase materially faster than the CPI.” *Id.* at 58. The cited language from Order No. 547 correctly states that the means for providing rate stability and predictability under the current system is the CPI-U adjusted price cap. However, the Commission did not address in Order No. 547 the extent of the Commission’s authority under § 3622(d)(3) to change the market dominant system.

Order No. 4400, also cited by ANM, fails to demonstrate conclusively that the CPI-U adjusted price cap is immune from adjustment. The statement in Order No. 4400 that certain rate increases “would contravene the objective of predictability and stability in rates” was not directed at the level of the proposed increases, but, rather, at the Postal Service’s proposal to a phase-in schedule with the reservation that it might “find it necessary to terminate the phasing mid-cycle....” Order No. 4400 at 16. An abrupt and unexpected termination of a plan for phasing-in rate changes is obviously both unpredictable and unstable. Order No. 4400, like Order No. 547, does not prohibit the

Commission from adopting the Public Representative's recommendations for adjustments to the price cap.

ANM's attempt to draw a connection between long-term price stability, as defined by central bankers, to the CPI-U inflation adjustment factor is, once again, another form of the ANM's argument that the CPI-U adjusted price cap mechanism precludes any and all changes to the market dominant system that would give the Postal Service the opportunity to collect additional revenues. In ANM's view, Objective 2's "rate stability" can only be achieved under the current CPI-U-adjusted cap. That view is overly narrow and, in this case, would prohibit the Commission from correcting defects in the current market dominant system. If adopted, the Postal Service would be prevented from ever having the opportunity to collect costs imposed upon it that are beyond its control. It would be required to continue sustaining losses generated by the underwater Periodicals Class. Such a result is contrary to those provisions of the PAEA that gave the Commission the authority to modify the current system to achieve the statutory objectives and to establish principles of price cap regulation as discussed by Drs. Kwoka, Wilson, and Brennan.

It should not go unnoticed that the ANM's rigid interpretation of the rate stability and predictability and the uncompromising pre-eminence that it ascribes to that interpretation is inconsistent with its argument that the Commission must balance all of the objectives in proposing modifications to the current market dominant system. In insisting that the CPI-U adjusted price cap is immutable, ANM makes the same mistake it accuses the Commission of doing with respect to the objective of financial stability.

The Public Representative does not seek to eliminate the price cap. Indeed, the Public Representative supports continued use of the CPI-U adjusted price cap. *Supra*, section III.C.1. Rather, the Public Representative proposes adjustments that would permit recovery of costs due to exogenous factors (employee benefit program costs and declining demand due to factors outside the Postal Service's control) and full cost

recovery for the Periodicals Class. As Dr. Kwoka has stated, price cap regulation is intended to provide predictable and stable rates by, among other things, controlling costs. Kwoka Decl. at 56. Price cap regulation, including the CPI-U price cap established by the PAEA, was not intended to provide predictable and stable rates by denying recovery of costs over which the Postal Service cannot exercise control. Nor does price cap regulation seek to provide predictable and stable rates by denying the Postal Service the opportunity to seek recovery of costs incurred in providing service as is currently the case with respect to the Periodicals Class.

The adjustments proposed by the Public Representative to recover exogenous costs for retiree health and pension benefits are projected to remain relatively constant over the next 5 years. As such, adjustments for these costs would be stable whether they are granted on a one-time basis or are phased-in.

Adjustments for changes in demand would be made annually. Annual adjustments foster stability by spreading out price changes. Using his proposed methodology, Dr. Brennan calculated an average annual price adjustment for the three largest postal services by revenue over the period from 2006 to 2015 to be less than 1.3 percent. Brennan 2017 Decl. at 18-20. In his supplemental declaration, Dr. Brennan calculated the price adjustment for specific mail classes for FY 2018. Brennan Supp. Decl. at 7-9.

An increase in the price cap for the Periodicals Class would also provide for rate stability whether implemented on a one-time basis or phased-in over time. Once implemented, the adjustment(s) to the cap would change only in response to changes in the CPI-U index.

4. Objective 3 (maintain high quality service standards).

The Public Representative has previously taken the position that it is premature to impose a price cap adjustment for service quality until additional revenues are available through adjustments to the price cap for exogenous factors and to the [price cap applicable to the Periodicals Class. PR 2017 Comments at 60. If, after the Postal Service's financial position has had an opportunity to improve, service quality does not improve or declines further, the Commission should consider the adoption of penalties or incentives to spur improved service performance. *Id.* The Public Representative submits that his proposed adjustments to the price cap are consistent with, and foster, the achievement of Objective 3.

5. Objective 4 (allow pricing flexibility).

The Public Representative's proposals would impose no restrictions on the Postal Service's pricing flexibility. In the case of Marketing Mail Flats, the Public Representative recommends an upward adjustment of the price cap for Marketing Mail. The Postal Service would retain its current rights to price products within the cap. With the additional cap authority, the Postal Service would be expected to address the non-compensatory Marketing Mail Flats issue subject to continuing Commission oversight.

With respect to the Periodicals Class, the Public Representative recommends adjusting the cap to permit full cost recovery. Following adjustment of the cap, the Postal Service would have increased opportunities to exercise flexible pricing authority. The Public Representative submits that his proposed adjustments to the price cap are consistent with, and continue to foster, the achievement of Objective 4.

6. Objective 6 (reduce administrative burden and increase transparency of the ratemaking process).

The Public Representative's proposals can be implemented without a significant increase in administrative burdens or a decrease in transparency. The proposal for exogenous cost recovery can be implemented using methods previously employed by the Commission. The amounts to be collected are projected to be relatively stable for at least the next five years. See PR Initial Comments at 54, Table 8. One possible mechanism would be to translate the dollar amounts to percentages that could be imposed as surcharges on mail classes in much the same manner as the exigent surcharge. Once the mechanism was established, the exogenous costs could be updated annually and the surcharge revised accordingly.

Similarly, a mechanism for implementing the proposed exogenous factor adjustment for declines in demand could be structured and updated periodically as described in the declarations of Dr. Timothy J. Brennan. See Brennan 2017 Decl. at 15-20; Brennan Supp. Decl. at 4-7, 10-12, Appendix A.. The implementation of Dr. Brennan's adjustment mechanism for changes in demand for each mail class will impose only minor administrative burdens on the Commission that would be comparable to those borne by the Commission in publishing CPI-U data.

The Commission currently publishes updated CPI-U data on its website quarterly. Using information in the Postal Service Econometric Estimates of Demand Elasticity for All Postal Products filed by the Postal Service every January, the Commission could publish on its website the estimated demand adjustment percentage for the following calendar year.<sup>39</sup> The Commission's website could also provide interested persons with a calculator to generate their own alternative or updated

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<sup>39</sup> The data used to make such estimates is the same data previously filed by the Public Representative in this proceeding as Library Reference PR-LR-RM2017-3/1, Supporting Calculations and Sources, March 1, 2018, and referred to by Dr. Brennan on page 7 of his supplemental declaration. Supplemental Declaration of Timothy J. Brennan for the Public Representative, March 1, 2018.

estimates of the adjustment for the following calendar year. Publication of the estimated adjustment and the availability of a calculator would also satisfy the objective of transparency of the ratemaking process. Once established, there should be no significant increases in administrative burdens or decreases in transparency.

Finally, the price cap for the Periodicals Class can be adjusted to achieve full cost recovery. Issues such as the proper level of costs to be recovered would have to be resolved. Once resolved, however, the price cap would continue to operate in the same manner it operates under the current system.

The Public Representative submits that his proposed adjustments to the price cap are consistent with, and foster, the achievement of Objective 6.

7. Objective 7 (enhance mail security and deter terrorism).

The Public Representative's proposed adjustments to the price cap are not designed to enhance mail security or deter terrorism. Nor would the proposed adjustments degrade either mail security or the deterrence of terrorism. The Public Representative submits that his proposed adjustments to the price cap are consistent with, and foster, the achievement of Objective 7..

8. Objective 8 (establish and maintain a just and reasonable rate schedule for rates and classifications).

ANM asserts that the Commission's proposed changes to the existing market dominant system violate Objective 8.<sup>40</sup> ANM asserts that Objective 8 requires rates to be "just and reasonable"; that the term "just and reasonable" is a term Congress should be presumed to have understood at the time it enacted Objective 8; and that the term

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<sup>40</sup> ANM Comments at 62-71; ABA Comments at 8. ANM also alleges that the Commission's proposals violate 39 U.S.C. 404(b). *Id.* at 62. Section 404(b) authorizes Postal Governors to establish rates and fees. It is unclear how the Commission's proposed actions under 39 U.S.C. section 3622(d)(3) violate a code provision that authorizes actions by the Postal Governors.

“just and reasonable” has long been understood to require that rates fall within a “zone of reasonableness”, meaning that rates are to be neither less than compensatory nor excessive. *Id.* at 62-63.

According to ANM, the “obvious issue” is whether it would be just and reasonable to raise prices on market-dominant products prices above the level of inflation if the Postal Service “does nothing to reduce its massively inflated costs or take advantage of the alternative sources of revenue and cost savings available to the Postal Service now and in the foreseeable future....” *Id.* at 64. ANM also asserts that an increase in the rates for periodicals will have severe impacts. *Id.* at 64-71.

These arguments do not prevent the Commission from adopting adjustments to the price cap as proposed by the Public Representative. The proposed adjustment for exogenous factor costs is not affected by Postal Service efforts to reduce costs. Exogenous costs are beyond the Postal Service’s control. In the case of retiree health and pension benefits, they are imposed by statute and are legal obligations of the Postal Service. In the case of declining demand due to changes in demographics or consumer preferences, they are also beyond the Postal Service’s control. For the reasons set forth in the Public Representative’s initial comments, these exogenous costs should be recovered by means of adjustments to the price cap. PR Initial Comments at 43-44, 55-56.

In addition to exogenous factor costs, the Postal Service should have the authority to seek recovery of all Periodicals Class costs. The “zone of reasonableness” established by “just and reasonable” standard in Objective 8 requires that the rates for the Periodicals Class be compensatory. For that reason, the Public Representative advocates an adjustment to the price cap for the Periodicals Class to permit full cost recovery.

Arguments raised by ANM regarding excessive costs, alternative sources of revenues, and opportunities for cost reductions should be addressed by the



Commission in determining the level to which the rate cap for the Periodicals Class should be raised. In addition, the Commission can properly consider whether the impact of an increase in the price cap should be mitigated by phasing-in the additional cap authority.

9. Objective 9 (allocate total institutional costs between market dominant and competitive products).

The Public Representative discusses Objective 9 in section III.D., above.

F. Impact of the Public Representative's Proposals

Opponents of the Commission's proposals express concerns over the adverse impacts they predict will result if prices are increased above the CPI-U-adjusted cap. The same objections will undoubtedly be raised in response to the Public Representative's proposals. The problems presented by the Postal Service's current situation have no easy solutions.

The Public Representative's proposal seeks to balance the interests of the Postal Service and the interests of its customers within the parameters of the existing market dominant price cap system. The proposed adjustments for exogenous factors and the adjustment of the price cap for the Periodicals Class seek to provide a principled means of giving the Postal Service opportunities to increase its postal revenue without undermining such virtues of price cap regulation as incentives to reduce costs and increase efficiency.

The first two adjustments to the system would build on the existing price cap system by offering the Postal Service the opportunity to recover costs beyond its control without undermining the other statutory objectives. The third adjustment would address the fact that the Periodicals Class is noncompensatory, based on the premise that price cap regulation is not intended to ensure the provision of services below cost.

To response to the needs of the Postal Service's customers and, in particular, their concerns over the impacts of rate increases, the Public Representative has proposed (1) a phase-in of the proposed exogenous cost adjustment; (2) further consideration, if necessary, before implementation of the exogenous factor adjustment for declining demand; and (3) the opportunity in this proceeding to challenge costs that would be subject to recovery if the price cap for the Periodicals Class were adjusted, coupled with the possible phase-in of any cap increases.

The Public Representative's proposals would be only one part of what must be a broader approach that includes legislation that addresses problems beyond the Commission's authority to address. As discussed above, the Public Representative has formulated his proposals with an eye toward some of the legislative proposals that may be enacted. In that respect, the Public Representative's proposals are a potential transitional mechanism.

In the meantime, if the Public Representative's proposals agree adopted, they would not relieve the Postal Service of its continuing obligation to responsibly reduce costs and increase efficiency. Nor would the Commission's oversight of those activities be affected. In addition, the Postal Service would still be required to observe the statutory provisions that recognize the special place that periodicals occupy under the postal laws. Moreover, an adjustment of the price cap system as proposed by the Public Representative would not, by itself, raise prices. It would give the Postal Service the opportunity to raise prices within a limited expansion of its pricing authority—a limited expansion based on measures that address design flaws in the original pricing regime.

The Public Representative submits that his proposals are a reasonable approach that gives fair consideration to the potential impacts of those proposals.

### G. Possibility of Legislation

In its comments, GCA asserts that legislation with the goal of restoring the Postal Service's financial stability is a real possibility. GCA Comments at 30. With that possibility in mind, GCA urged the Commission to "provide clearly against needless, and harmful, duplication of financial rescue mechanisms".<sup>41</sup>

The Public Representative agrees with GCA that the Commission should avoid changes to the market dominant system that seek to avoid "needless, and harmful, duplication." In a perfect world, Congress would proceed expeditiously to make whatever legislative changes it deems appropriate and the Commission would follow with regulatory proceedings that implement those changes and any additional changes necessary to fulfill its responsibility to conduct the 10-year review. But we do not live in a perfect world, and the financial situation of the Postal Service requires the Commission to proceed with the 10-year review pending possible action by Congress. The need for Commission action is underscored by the fact, which the Public Representative has urged the Commission to recognize, that the Postal Service lacks short-term financial stability. Cite^ Commission action is also required because there is no way of knowing with certainty whether or when Congress will act.

The Public Representative submits that the changes it proposes to the existing market dominant system will avoid "needles, and harmful, duplication." First, the exogenous cost adjustments to the price cap proposed by the Public Representative are targeted at employee benefit payment obligations that are projected to continue. They are consistent with amounts for which the Postal Service projects it will remain liable under the version of H.R. 756 reported by the House Oversight and Government

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<sup>41</sup> As a general matter, the Public Representative agrees with GCA that the Commission should not assume that currently pending legislation will be enacted. However, the mere uncertainty over the ultimate content of postal legislation should not prevent the Commission from acting. Rather, the Commission should remain informed regarding legislative developments and take actions which, based on the best available information, appear consistent with potential legislative outcomes. At the present time, the provisions of H.R. 756 appear to present the most likely basis for new postal legislation.

Reform Committee on March 16, 2017. PR Initial Comments at 51-55. Thus, the 3-year phase-in of the Public Representative's exogenous cost adjustment would authorize \$6.17 billion of additional rate authority over the first 2 years. *Id.* at 49, Table 5. The net Postal Service exogenous health benefit and pension costs for 2018 and 2019 would be \$6.616 billion. See *id.* at 54, Table 8. Assuming passage of H.R. 756, the residual amount of health benefit and pension cost liability shown in Table 8 would be slightly larger than, but clearly compatible with, the exogenous cost price cap adjustment shown in Table 5.

Second, the exogenous factor adjustment to the price cap for declining demand proposed by the Public Representative is an adjustment that is neither required nor precluded by H.R. 756. The Commission is free to consider the declining demand adjustment on the merits without interfering with the provisions of H.R. 756.

Third, the Public Representative's proposal to increase the price cap for Periodicals to cover costs, as discussed above, is another change to the current market dominant system that can be considered without interfering with the provisions of H.R. 756.

In light of the foregoing, the Public Representative submits that the Commission can design its proposals to be consistent, to the maximum extent reasonably possible, with legislative proposals that have a realistic opportunity for enactment.

#### H. Next Steps

The Commission's proposals have drawn strong objections from across the commenter spectrum. Under the circumstances, the Commission has several options. First, it can issue a final order adopting its proposal with, or without, changes. Second, it can adopt one of the alternative proposals presented by one of the commenters with or without modifications. Third, it can issue an interim order authorizing partial relief based on the record developed thus far, while continuing to consider further relief with

or without further supplementation of the record. Fourth, the Commission can formulate a new proposal based on consideration of the comments received thus far and provide an opportunity for comment on that proposal. The Commission, however, must take some action.

Before proceeding to the next step in the review, the Commission should consider whether a further notice would be required. Under the Administrative Procedure Act, 5 U.S.C. § 553(b), agencies must provide general notice of their intentions and rationale so that members of the public can comment in a meaningful way. If an agency changes course in its final rule, it has violated this notice requirement unless the final rule was a “logical outgrowth” of the notice. See *e.g.*, *NRDC v. Thomas* 838 F.2d 1224, 1242 (D.C. Cir. 1988); see *Nat’l Min. Ass’n v. Mine Safety & Health Admin.*, 116 F.3d 520, 531 (D.C. Cir. 1997) (commenting that “[o]ur cases offer no precise definition of what counts as a ‘logical outgrowth.’”). To evaluate this, a court considers “whether ‘the purposes of notice and comment have been adequately served.’” *American Water Works Ass’n v. EPA*, 40 F.3d 1266, 1274 (D.C. Cir. 1994) (quoting *Fertilizer Inst. v. EPA*, 935 F.2d 1303, 1311 (D.C. Cir. 1991)).

If additional procedures are necessary, the Public Representative urges the Commission to issue an interim order granting partial relief to relieve the Postal Service’s short-term financial instability. At a minimum, that relief would consist of an adjustment to the price cap to permit the recovery of exogenous costs. The basis and magnitude of that authorization is discussed in the Public Representative’s March 1, 2018 comments. PR Initial Comments at 40-55. Consideration of all other issues, including the Public Representative’s recommendations that the price cap be adjusted for declines in demand for exogenous factors and that the price cap for the Periodicals Class be raised to permit full cost recovery, would continue based upon the record as it exists or as supplemented.

As an alternative, the Public Representative would urge the Commission to formulate a new proposal based on the comments received to date and to provide an opportunity for initial and reply comments. However, if the Commission chooses this option, it should be prepared to act promptly. Unless the legislation that numerous commenters point to as the solution to the Postal Service's problems is enacted soon, the Postal Service's financial situation will continue to deteriorate. That is not an acceptable situation for the Postal Service, its unions, its customers, or the American public.

#### IV. CONCLUSION

For the reasons given above, the Public Representative submits that the system for regulating rates and classes for market dominant products should be modified as recommended herein.

Respectfully submitted,

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